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To: Members of the Executive Board

From: The Secretary

Subject: Financing Requirements for Countries of Central and Eastern Europe and the States of the Former Soviet Union

Attached for the records of Executive Directors are the statements made by the staff representatives on the financing requirements for the countries of central and eastern Europe and the states of the former Soviet Union at Executive Board Seminar 92/2 (9/9/92).

Att: (1)

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Department Heads

Statements by the Staff Representatives on
Financing Requirements for Countries of
Central and Eastern Europe and the States of the Former Soviet Union
Executive Board Seminar 92/2 - September 9, 1992

The staff has discussed external financial requirements for 1992 for the countries of central and eastern Europe with the G-24 and the Executive Board on several occasions since the Bangkok meetings as programs were negotiated and information was needed on the availability of such financing. In this process, the information obtained was naturally reflected in the adjustment policies included in the programs to be supported by Fund resources. In the end, specific requests for new financing were presented to the G-24 at the time of the conclusion of the negotiations for Bulgaria (US$240 million in March 1992), Romania (US$180 million in May 1992), and Albania (US$65 million in June 1992). As anticipated, no requests were put forward in the cases of Hungary, Poland, and the Czech and Slovak Federal Republic. The most recent estimates indicate, on aggregate, a somewhat smaller requirement than presented earlier, because of lower import levels due to the continued economic weaknesses and to delays in disbursement of identified official financing. While limited absorptive capacity may explain in part the shortfall, the smaller disbursements also reflect problems with burden sharing among the Group of Twenty-Four. In addition, official support from the Paris Club through debt rescheduling made significant contributions to the programs of Bulgaria and Poland.

The contribution of private capital inflows remains modest, except in the cases of the Czech and Slovak Federal Republic and--especially--Hungary. Particularly noteworthy has been the major increase in direct investment in these two countries.

From this experience, a few important points can be made on issues relating to financial requirements for 1993.

First, there is a need to bring about a recovery in economic activity and investment. This will not only require the determined pursuit of reform by these countries, but also a significant lessening of the balance of payments constraint. While exceptional balance of payments financing will not be needed or requested for Poland, Hungary, and the Czech republic, substantial external support will continue to be required for Albania, Bulgaria, Romania, and most probably, for the new republic of Slovakia.

Second, as we approach the second and third year of program implementation, there may be a need to rethink our approach to financial assistance. As absorptive capacity increases with the progress of reform, more emphasis will have to be put on access to foreign resources (e.g., export credit agencies, development banks, or other long-term lending institutions) to support specific investment projects.

Third, reforming countries will have to adopt measures aimed at stimulating the inflow of private capital. The success of the Czech and Slovak Federal Republic and Hungary in this respect in 1992 shows that progress on reforms and adequate incentives will elicit a response from the private sector.

Fourth, discussions with private banks will need to be successfully concluded in the cases of Albania, Bulgaria, and Poland if medium-term viability is to be achieved. While some progress has been made, particularly in the most recent weeks, agreements on adequate terms are still not in prospect for before the end of this year. Here again, some official prodding may be needed.

Fifth, market access for central and eastern European exports must be improved, particularly in the delicate areas of agriculture, textiles, and steel.

The balance of payments of countries in central and eastern Europe will remain fragile, reflecting their weak economic positions. While increasing reliance is being placed on regional development banks and the IBRD, as well as continued support from the IMF, there remains an important role for official financial assistance, particularly for those countries where the inflow of private capital is not expected to reach significant levels in the next few years.

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The arrangements for financing for the states of the former Soviet Union are well behind those that have been made for most countries in eastern and central Europe. However, the process of arranging financing for the states of the former Soviet Union has begun, with the financing package for Russia announced by the Group of Seven in the spring, and the financing assurances for the three Baltic countries, which we expect to receive shortly.

Looking ahead, considerable external financial support is likely to be required for those countries pursuing strong economic reform and stabilization programs. The countries of the former Soviet Union differ markedly, and are likely to require financing on different time scales and of different types, depending on their particular circumstances. It is, however, too early to provide figures, because we are still grappling with the gaps in the data and the uncertainties about the programs which might be adopted.

The procedures for arranging the required financing are becoming clearer following discussions in various fora. For the Baltic countries, the G-24 process has so far been successful in organizing financing in support of the programs which will be discussed by the Board in the coming weeks. For the states of the former Soviet Union other than the Baltics and the Russian Federation, it is envisaged that financing, together with the monitoring of the reform effort and the coordination of technical assistance, can be arranged in the framework of consultative groups chaired by the World Bank. The Fund would take the lead in discussions of balance of payments financing. Such groups would enable a differential approach to each country to be adopted, reflecting the particular circumstances. If consultative groups go ahead, it is envisaged that the first groups might be for Kazakhstan and Kyrghyzstan. To prepare the ground for these, a team consisting of representatives of the Fund, the Bank, and the Governments of Kazakhstan and Kyrghyzstan visited a number of capitals of creditor countries in August to explain what is envisaged. The proposed arrangements were welcomed.

Turning to the Russian Federation, as discussions about a program for the Russian Federation for 1993 proceed, and estimates of the balance of payments financing requirement are made and agreed with the Russian authorities, it will be necessary to discuss the situation with creditors. Our current thinking is that the Fund and the Bank should call a meeting of major creditors, international financial institutions, and the Russian authorities at a technical level in October. This meeting would review the financing experience in 1992, exchange views on financing issues for 1993, discuss the outlook for the 1993 balance of payments on the basis of preliminary estimates, and consider the next steps in addressing the financing requirements. There would obviously need to be one or more subsequent meetings as the economic policy framework for 1993 firmed up.